SENATE MAJORITY POLICY OFFICE

BILL ANALYSIS

Bill Number: SB 94, 95 and 96 Senator Cassis

Analyst: Howard Ryan

Date: 3 May 2007

HIGHLIGHTS

- This bill creates a new business tax structure in the state.
- The plan's focus is on the ***stimulation of the Michigan economy.***
- The new tax is a combination of a modified gross receipts tax plus a modest business income tax.
- Taxpayers, with gross receipts under $15 million, will be able to *choose* to pay the modified gross receipts tax or a modest business income tax.
- A Michigan Entrepreneurial Credit is included in the package which affords a 100% credit for firm under $15 million in gross receipts that add jobs and invest in Michigan.
- All new industrial personal property would be exempt beginning in 2008.
- The plan also offers a 25% credit for industrial and commercial personal property acquired within the past 5 years.

SUMMARY:

This set of three bills (SBs 94, 95 and 96) creates a new business tax structure in Michigan. The bills would replace the Single Business Tax which is scheduled to be repealed at the end of this year. The package is known as the BEST Plan, Business and Economic Stimulus Tax.

The Senate Finance Committee has reviewed a number of tax plans offered by the Michigan, Detroit and Grand Rapids Chambers of Commerce, the Administration, and Professor Wolfram from Hillsdale College. All these plans have strengths and weaknesses. The Senate Republican Plan, offered here by Senator Cassis, shares the best from these plans and integrates these elements into a plan that offers a substantial and competitive improvement from the current state of business taxation in Michigan.

To stimulate economic growth, business investment and job growth Senate Republicans offer the following comprehensive plan to replace Michigan's Single Business Tax. While any tax plan should seek to provide for fairness among taxpayers, efficiency, simplicity and stability, this plan's focus is on the ***stimulation of the Michigan economy*** and therefore on job growth and investment.

This plan involves a modest business income tax and a modified gross receipts tax (MGRT), less purchases from other firms (equivalent to a sales tax). In addition this plan offers an option to taxpayers to pay either the modified gross receipts tax or the income tax for firms with gross receipts under $15 million.

The following are the highlights of the BEST plan:

- Firms with sales over $15 million would pay the MGRT, Gross Receipts Tax less purchases from other firms, plus the business income tax

- The plan would reduce business taxes by $290 million which would stimulate Michigan's economy.

- The plan, as introduced, would replace $1.56 billion of the approximately $1.85 billion generated by the SBT. The bill now provides for a approximately $1.25 billion in revenue with the addition of the credit for compensation for managerial and professional positions.

- The plan will allow firms the option of paying business taxes in combinations that will likely reduce their overall exposure and may reduce the incidence of the tax (who actually pays the tax) on the businesses.

- Approximately 75 percent, or $1.0 billion, of the revenue would be raised by the modified gross receipts tax. The rate of the modified gross receipts tax is set at .54%.

- The remaining 25 percent, or $304 million, would be raised by a modest business income tax. The rate of the business income tax is set at 1.5%.

- Firms with gross receipts over $350,000 but under $15 million would be able to *choose* to pay the modified gross receipts tax or the business income tax. Businesses would have to elect to pay either tax for 3 years.

- Because a majority of firms will opt to pay the business income tax more than 90% of firms that currently pay the SBT will be better off under the BEST plan (100,000 of 108,000 firms that currently pay the SBT).

- Smoothing credits were created to deal with the "cliff" problems faced by firms that exceed the $350,000 and $15 million gross receipts thresholds. These credits will save hundreds of small and medium sized firms millions of dollars in tax liability and further energize firms with gross receipts between $15 and $50 million.

- A "Michigan Entrepreneurial Exemption" or M-E 2 target small businesses and would provide that firms under $25 million in gross receipts would ***pay no taxes for up to five years,*** if the firm meets certain job growth and investment criteria. Firms would be required to add 20 new jobs in the previous year and invest at least $1.25 million in capital in the previous year.

This portion of the plan, in concert with the choice offered firms under $15 million, will greatly mitigate the need for other economic development incentives and the monies currently used for economic development could be used for overall tax relief.

- The tax would be apportioned 100 percent on sales.

- The tax would ***completely exempt new industrial personal property*** and would provide a 20% PPT credit for recently acquired Industrial and commercial personal property, acquired within the previous five years.

- A circuit breaker so that if revenues from the taxes exceed $1.56 billion adjusted for inflation plus 1%, the rate of the gross receipts tax will be adjusted downward.

Senate Bill 94

This bill is the main bill in the package and creates the body of the modified gross receipts tax which form the basis of the new tax system. Included in the bill are a number of key *definitions* including the definitions of "purchases from other firms" and "inventory" necessary for creation of a modified gross receipts tax (essentially a sales tax on business). The bill also contains the circuit breaker language which constrains the growth of the revenue from the tax to inflation plus 1%. The following key elements are also included in the bill:

- The M-E-2, Michigan Entrepreneurial Credit, which allows firms with gross receipts under $25 million a 100% tax credit for up to three years if the firm creates at least 20 jobs in the previous year and invests at least $3 million in capital in the previous year or invests $5 million in the previous 2 years.
- A "clawback" provision would require a taxpayer to pay back an amount equal to all the M-E-2 credits received if the taxpayer were to leave the state within 5 years of having received the credit.
- Choice provisions which allow the taxpayer to choose which portion of its tax base will be subject to tax.
- A 10% industrial personal property tax credit for property acquired with the last 5 years.

The committee substitute for this bill clarifies the definition of "purchases from other firms" and also makes technical fixes to the circuit breaker language.

The bills in the package are tie-barred.

Floor Substitute and Amendments to SB 94

The floor substitute (S-6) contains the following changes:

- Incorporates language to require unified filing. Language requiring unitary business filing will reduce the degree of tax planning that firms engage in and make for a more efficient tax. This language was taken from the Michigan Chamber's tax plan. The Governor's tax plan, MBAT, also contains language requiring unitary filing.
- Incorporates the move away from the franchise tax. The original best plan included a franchise tax and the floor substitute strikes the language concerning this tax. The franchise tax brought up concerns about compliance and administration and was viewed by the business community as problematic for those reasons.
- A smoothing or "cliff" credit is added to smooth out the "cliff problem" for firms that exceed the $15 million threshold in gross receipts. Essentially firms with gross receipts greater than $15 million will receive a larger credit as gross receipts approach the $15 threshold while firms with gross receipts approaching $50 million will have an increasingly smaller credit.
- The investment criteria for the ME-2 credit is reduced to $2 million in the preceding year and the maximum number of years that firms are eligible for the credit is increased from 3 to 5 years.
- Sourcing language is amended to favor the export of services.
- The PPT credit is increased to 20% and commercial personal property is included to expand PPT relief across a broader spectrum of businesses.
- The credit allowed for firms taxed under PA 282 of 1905, essentially utilities and railroads, is added to the bill. This 5% credit was included in the SBT and is being added to offset the tax liability of large telecommunication companies, principally AT &T.

Amendments on General orders

- *Language concerning the $100 fee for small firms with gross receipts between $100,000 and $350,000 will be struck. This will relieve thousands of small firms from the burden of paying the fee.*

- *The definition of inventory is amended to clarify that electricity purchased is included as inventory and therefore subtracted from gross receipts. This amendment helps small utility co-ops.*
- *A Headquarters credit is added to incentivise Firms to locate headquarters in the state.*
- *The PPT credit is increased from 20% to 25% to help offset Michigan's uncompetitive position concerning personal property taxes.*
- *A clear and definite nexus standard is incorporated into the bill. This language is from the current SBT and was also included in the Michigan Chamber's tax plan.*
- *Language which allows a deduction for compensation for personnel businesses is added.*
- *Language which creates a credit for restaurants that adopt a no-smoking policy is offered to reduce health care costs and to offset any loss of business.*

Amendments and Sub for Third Reading

The substitute for SB 94 (S-8) contains the following changes:

- *A new section is added to the bill which creates a capital tax for banking institutions. This stand alone section is preferred by the banking community and represents extensive negotiations with the banks.*
- *A new 20% credit for taxes paid by a telephone company is added to the bill. This would help create parity in the taxation between cable and telephone companies (AT&T etc.).*
- *The capital requirement for the ME-2 credit is reduced from $2m to $1.25M to allow more firms to qualify for the credit.*

Amendments

The following amendments will be offered to the S-8 substitute:

1. *An amendment to reduce the rate on the capital tax for banks to .225%.*
2. *Amendments to restore the Historic Preservation and Higher education credits.*
3. *A credit for capital expenditures made to a motorsports complex.*
4. *An amendment that provides a credit for contributions to an endowment fund of a community foundation or a school foundation.*

Substitutes for SBs 95 and 96

Substitutes for Senate Bills 95 and 96 make technical changes to ensure that the industrial property tax exemption functions properly, in the case of SB 96 and that the rate is sufficiently modest in the business income tax bill. The rate for the business income tax is set at 1.5%.